No. 96-871

Supreme Court, U.S.
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IN THE
Supreme Court of the United States
OCTOBER TERM, 1996

STATE OIL COMPANY,
Petitioner,
v.
BARKAT U. KHAN and KHAN & ASSOCIATES,
an Illinois Corporation,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF AMICUS CURIAE OF NATIONAL ASSOCIATION OF MANUFACTURERS IN SUPPORT OF PETITIONER

MARK L. DAVIDSON
Counsel of Record
1155 Connecticut Ave., N.W.
Washington, DC 20036
(202) 429-6650
Attorney for Amicus Curiae

Of Counsel:
JAN S. AMUNDSON
General Counsel
QUENTIN RIEGEL
Deputy General Counsel
NATIONAL ASSOCIATION OF MANUFACTURERS
1331 Pennsylvania Ave., N.W.
Suite 1500—North Lobby
Washington, DC 20004

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INTEREST OF AMICUS CURIAE

The National Association of Manufacturers ("NAM") is the nation's oldest and largest broad-based industrial trade association. NAM's 14,000 member companies and subsidiaries—including approximately 10,000 small manufacturers—are in every state and collectively produce 85 percent of U.S. manufactured goods. The majority of these members distribute their products through independent wholesalers and retailers. Hence, NAM's membership is keenly interested in any antitrust case that bears materially on distributive practices. *State Oil Co. v. Khan*, No. 96-871 (Sup. Ct., *cert. granted*, Feb. 18, 1997) is of particular concern because that case presents this Court with a watershed opportunity to restore to legitimacy the

procompetitive practice of vertical maximum resale price setting by overruling *Albrecht v. Herald Company* ("*Albrecht*"), 390 U.S. 145 (1968) which held that such price fixing was *per se* illegal.[1] Acting on that interest, NAM, pursuant to Supreme Court Rule 37.3, sought and obtained the written consent of the parties to its participation as an *amicus* so that it might argue, in support of the petitioner, that the redeeming virtues of vertical maximum resale price setting make *per se* treatment of that practice inappropriate and mandate instead for a traditional rule of reason analysis.[2] The requisite consents to NAM's participation have been filed with the Clerk of the Court.

SUMMARY OF ARGUMENT

State Oil presents this Court with a unique opportunity to re-examine *Albrecht* and supplant that case's *per se* approach to maximum resale price fixing with a rule of reason analysis. The *Albrecht* Court fell into error in reasoning by analogy. That Court determined that if *minimum* resale price fixing was per se unlawful then, by a parity of reasoning, so should *maximum* resale price setting. But, of course, supplier-sponsored maximum price fixing is not inimical to competition nor is it perniciously

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[1] A practice is said to be *per se* unlawful when it is so inimical to competition that, in place of a consideration of that arrangements' merits to see if it is "reasonable" under the antitrust laws, the practice is instead conclusively presumed to be "unreasonable", and, hence, unlawful. In that event, proof of the arrangement alone suffices to prove the Sherman Act violation. See, *Arizona v. Maricopa County Med. Society*, 457 U.S. 332, 342-44 (1982); *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958).

[2] Instead of presuming illegality, the rule of reason calls for a broad ranging fact-based economic inquiry regarding the market affects of a challenged practice to determine if it is anticompetitive, i.e., "unreasonable" under the antitrust laws, or whether there are procompetitive effects that justify the practice, rendering it "reasonable" and, hence, lawful under the Sherman Act. See, *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918).

anticompetitive. On the contrary, that practice, employed in appropriate circumstances, can produce important distributional efficiencies and demonstrable consumer benefits. Because vertical maximum resale price fixing has such redeeming market virtues and social utility, it should be assayed by the rule of reason and not, as now, conclusively presumed unlawful.

ARGUMENT

A. *State Oil* Presents This Court With A Unique Opportunity To Re-examine *Albrecht* And To Supplant With A Traditional Rule Of Reason Analysis That Earlier Case's *Per Se* Approach To Maximum Resale Price Fixing

The *State Oil* case is the perfect vehicle for re-evaluating the *Albrecht* case's use of a *per se* rule to outlaw supplier-originated maximum resale price setting. *State Oil* is virtually indistinguishable factually and economically from *Albrecht*. See, Opinion of the Court of Appeals ("Appellate Op") Petitioner's Appendix ("Pet. App".) at 10a.

Albrecht concerned a newspaper publisher's practice of imposing a ceiling on the price at which it would permit its exclusive dealers to resell the *Herald* newspaper in their respectively assigned territories. The *State Oil* case involved much the same practice, although the affected commodity was gasoline rather than newspapers. In *Albrecht*, the *Herald* publisher decreed specified maximum prices; State Oil instead set a suggested retail price for each of its brands of gas and then sold that gasoline to a gas station operator for 3.25 cents under that suggested price. As contractually, any revenue in excess of the specified 3.25 cent margin had to be rebated, State Oil's suggested price, just like the *Herald*'s ceiling price, was actually a maximum retail sale price.

A reconsideration of *Albrecht* now, in the context of *State Oil*, is not merely appropriate but also decidedly timely. It has now been nearly thirty years since the *Albrecht* decision. In the intervening years, this Court has had a significant exposure to the procompetitive

virtues of vertical non-price restraints and supplier sponsored maximum resale price setting. *See, e.g., Atlantic Richfield Co. v. USA Petroleum Co.*, ("*Arco*"), 495 U.S. 328, 333 (1990) (Maximum resale price setting "does not cause a competitor antitrust injury unless it results in predatory pricing"; maximum price fixing has the effect of lowering prices to consumers); *Business Elec. Corp. Sharp Elecs. Corp.*, 485 U.S. 717, 724 (1988) (No vertically imposed restraint should be judged *per se* illegal unless it involves the actual setting of prices); and, *Continental TV, Inc. v. GTE Sylvania, Inc.* ("*Sylvania*"), 433 U.S. 36, 50 (1977) (Exclusive dealer territories analyzed under the rule of reason; "departure from the rule of reason standard must be based upon demonstrable economic effect").[8]

In fact, it was a review of these and other recent vertical restraint precedents of this Court that moved Chief Judge Posner, writing for the panel below, to remark that this Court's holdings have effectively "doomed" *Albrecht* by rendering that case's theoretical basis for use of a *per se* rule not merely "infirm" but "increasingly wobbly" and "moth-eaten". Appellate Op. Pet. App. at 9a.

Notwithstanding his attack on *Albrecht*, Judge Posner declared that he and the *State Oil* appellate panel were nonetheless constrained by *stare decisis* to adhere to *Albrecht*'s *per se* rule in judging the antitrust legality of State Oil's setting of maximum resale price ceilings. *See, Caribe BMW, Inc. v. Bayerische Motoren Werke Aktiensgesellschaft*, 19 F.3d 745, 752-54 (1st Cir. 1994). Judge Posner explained that it lay only with this Court to over-

[8] So too, economic learning has progressed sufficiently in the period since *Albrecht* was decided such that through case exposure the judiciary has now gleaned sufficient knowledge of "industrial organization, cartel theory and dominant firm behavior to identify those conditions that must be satisfied before [concluding] that use of a particular vertical arrangement in a particular context is likely to cause social harm". See, Baxter, The Viability of Vertical Restraints Doctrine, 75 CAL. L. REV. 933, 947 (1987).

rule *Albrecht*; something that, given the right opportunity he said he fully expected this Court to do. *Id.* at 9a. This is that right opportunity.

B. The *Albrecht* Court Wrongly And Unnecessarily Outlawed Vertical Maximum Resale Price Setting

The *Albrecht* Court never made an assessment of the purpose and effect of supplier-originated maximum resale price fixing. The Court ignored any possible differences that might exist between vertical *maximum* resale price setting and *minimum* resale price maintenance, observing only that both practices equally usurped dealer pricing prerogatives. The Court instead focused on the fact that resale price maintenance had long been recognized as perniciously anticompetitive. *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). Reasoning by analogy, the Court concluded that maximum price fixing also should be banned as *per se* unlawful.

Maximum resale price setting differs, of course, in method, purpose and effect from minimum price fixing. Hence, the analogy that the *Albrecht* Court sought to draw was incorrect, a fact the dissent in *Albrecht* suggested by pointing out that the setting of a price ceiling is a natural procompetitive incident to a scheme of territorial exclusivity. 390 U.S. at 169.

C. Vertical Maximum Resale Price Fixing In Appropriate Contexts Actually Yields Efficiencies And Consumer Benefits

Manufacturer-set maximum resale prices produce real economic benefits. Thus, for example, in those rare instances where a dealer might have market power or, more likely, economic leverage, a supplier-imposed price ceiling can serve the valuable function of restraining a dealer's temptation to extract an artificially high price for the sub-

ject goods. Absent such restraint, artificially high dealer prices frustrate any attempt by a supplier to pass along any manufacturing efficiencies to the public in the form of reduced, more competitive prices. Instead, the dealer's artificially high price reduces demand for the manufacturer's product (effectively reducing output). And, at the same time, the public is forced to pay more.

It was this very fact pattern that was presented in *Albrecht*. The *Herald*'s dealers had a form of market power or economic leverage rooted in their exclusive territories and the fact that there was but one evening paper. The *Herald* wanted maximum circulation and so sought to put a ceiling on the price that could be charged by any of its dealers. When one of those dealers violated the ceiling and threatened to reduce output (in this instance, to reduce circulation), he was replaced with a more compliant dealer. The same economic benefits of a ceiling price discussed above were of course sought by the *Herald* in *Albrecht*. But, the *Albrecht* Court ignored these redeeming off-setting procompetitive virtues.

Another example of the social utility of maximum resale price fixing is illustrated in markets where there is a less expensive private label alternative to a full priced branded product; *e.g.*, over-the-counter drugs, cereal, soda, and health & beauty aids. Absent a manufacturer's right to set a price ceiling on its branded products, a dealer could inflate the retail price of the branded product, thereby, providing an umbrella for the sale of its private label goods at higher prices than might otherwise prevail for such unadvertised and unbranded items.

The result, once again, of this unchecked dealer activity is a reduction in the demand for the branded product and sale of the private label at an artificially high price. As a consequence, competition is suppressed in not one but two markets: The one for the branded product and the other for sale of the private label. The immediate effect of this is to increase the branded manufacturer's

cost of distribution while at the same time depressing its sales volume.[4] The consequences of this dealer behavior are significant: There is a loss of efficiency in distribution, reduction of the manufacturer's output (another way of saying lost sales and less effective interbrand competition), and diminished ability of the manufacturer to absorb fixed costs. As for consumers, they pay more for both the branded and the private label product.

Because of *Albrecht*, manufacturers for the last 30 years have not been able to use maximum resale price fixing to combat the distribution problems created by perfectly rational but nonetheless anticompetitive dealer behavior. Manufacturers have instead had to resort to promotional rebates and other forms of incentives to ensure that prices are reduced and interbrand competition spurred and intensified. But, dealers can often frustrate these strategies simply by keeping the rebate or not passing along any or all of the price reduction. As a result, the manufacturer's price reduction or incentive program fails to meet its promotional objectives. Instead, the dealers' profit margin is increased and the manufacturer gets none or few of the expected sales for its effort. So too, the consumer is denied the intended price benefits of the manufacturer's marketing program.

Manufacturer-set maximum resale price fixing obviates these problems while also securing consumers more competitive markets and, thus, lower prices. Supplier-sponsored price ceilings are, in fact, the most efficient means of insuring that efficiencies in manufacture, wholesale price reductions or promotional incentives are passed on to consumers.

There is little or no adverse effect on competition arising from the use of this practice. Maximum price setting is, in fact, largely antitrust benign. Judicious maximum

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[4] Distribution cost goes up because, by definition, a manufacturer's cost of distribution is the difference between the wholesale price to dealers and the retail price of the product.

resale price fixing threatens neither inevitable nor significant anticompetitive consequence. As this Court noted in *Arco*: Vertical maximum price fixing "does not cause a competitor antitrust injury unless it results in predatory pricing". *Id.* at 335 n.5, and 339-40. *See also, Indiana Grocery, Inc. v. Super Valu Stores, Inc.*, 864 F.2d 1409, 1416-1420 (7th Cir. 1989) (fixed non-predatory prices do not cause injury to competitors). Even dealers that have a maximum resale price imposed on them are not likely to be hurt because, if the practice performs in accordance with expectations, the dealer's sales will increase —at the expense of its competitors.

D. As Vertical Maximum Resale Price Fixing Has Undeniable Social Utility It Therefore Should Be Judged By The Rule Of Reason And Not Presumed Unlawful

In *Sylvania*, this Court explained that the rule of reason should be the presumptive test by which conduct is judged under the antitrust laws; a *per se* rule only should be invoked for practices that, in the overwhelming majority of instances, demonstrably threaten serious and pronounced anticompetitive consequences. *Sylvania*, 433 U.S. at 50 (1977). Put another way, a practice will not be conclusively presumed to be "unreasonable" and therefore *per se* illegal unless it is shown to have a "pernicious effect on competition and [to] lack [. . .] any redeeming virtue". *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958).

That is surely not the case with State Oil's maximum price setting, any more than it was true in *Albrecht* of the *Herald's* ceiling pricing. The *Herald*'s use of maximum resale price fixing as a distributional tool was never shown to augur severe anticompetitive market dislocations. And, there is nothing to suggest that State Oil's practice is anymore inimical to competition. To the contrary, it is plain that the *Herald*'s vertical price fixing and that of State Oil had legitimate business purposes and threatened no serious effect on competition, let alone a pernicious one.

In sum, maximum resale price fixing demonstrates "redeeming market virtues" that, under the standards of the antitrust laws, does not merit being treated as presumptively illegal. It is time to abandon *Albrecht*'s *per se* rule so that manufacturers, in proper contexts, may take advantage of the efficiencies of price ceilings as a distribution tool.

CONCLUSION

This Court is presented with few occasions when it can correct an error, dispel doctrinal disarray and supply an impetus to the intellectual development of an area of the law. But that is precisely what has happened here. Judge Posner has invited this Court to expressly overrule *Albrecht* and its *per se* approach to vertical maximum resale price fixing and substitute in its place a full fledged rule of reason inquiry. This is an invitation that this Court can and should accept.

Respectfully submitted,

MARK L. DAVIDSON
Counsel of Record
1155 Connecticut Ave., N.W.
Washington, DC 20036
(202) 429-6650
Attorney for Amicus Curiae

Of Counsel:
JAN S. AMUNDSON
General Counsel
QUENTIN RIEGEL
Deputy General Counsel
NATIONAL ASSOCIATION OF MANUFACTURERS
1331 Pennsylvania Ave., N.W.
Suite 1500—North Lobby
Washington, DC 20004

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